

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Haynes Analyst: Kristina E. North Bill Number: SB 1273
Related Bills: See Legislative History Telephone: 845-6978 Introduced Date: January 15, 2002
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Contributions to Nonprofit Educational Assistance Organization Credit/Private Funding for Educational Assistance Act

SUMMARY

This bill would create a credit for monetary donations to a nonprofit organization that provides scholarships to students.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to expand the educational opportunities of low-income children by encouraging taxpayers to make donations to a nonprofit organization that provides scholarships.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. This credit would apply to taxable years beginning on or after January 1, 2002.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist the author in resolving the implementation and policy considerations discussed below.

ANALYSIS

FEDERAL/STATE LAW

Current federal and state tax laws allow various tax credits designed to provide tax relief for taxpayers that incur certain expenses (e.g., child and dependent care credits), to influence business practices and decisions, or to achieve social goals.

Current federal and state tax laws allow a taxpayer to claim charitable contributions as an itemized deduction. Deductions are allowed for monetary charitable contributions or gifts of property to qualified organizations formed for religious, charitable, educational, scientific, or literary purposes. A charitable contribution is defined as a contribution or gift made exclusively for public purposes. A taxpayer is allowed to subtract the greater of the standard deduction or itemized deductions from his or her adjusted gross income when computing taxable income.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

03/21/02

Current federal and state tax laws place limitations on charitable contributions. The limitations vary from 20%, 30%, or 50%, depending on the individual's AGI and the amount of contributions made, the types of organizations that receive the donations, and the type of property donated. If an individual's charitable contributions are limited, the excess may be carried over for five years.

THIS BILL

This bill would create a credit for 70% of the total amount of any monetary contributions made by a taxpayer to a nonprofit educational assistance organization for pupil scholarships, educational assistance, and administrative expenses. This bill would specify that the credit would only be allowed if:

- ◆ the organization receiving the contribution provides a receipt to the taxpayer that includes the name of the organization, the name of the taxpayer, the amount of the contribution, and any additional information required by the Franchise Tax Board (FTB);
- ◆ the taxpayer's contribution is used only for the purposes authorized by this credit; and
- ◆ the taxpayer does not designate a specific pupil as the beneficiary of the contribution.

This bill would define a variety of terms for purposes of the credit, including "nonprofit educational assistance organization," "qualifying contribution," "qualifying pupil," and "school."

Any credit that exceeds the taxpayer's tax liability could be carried over for up to five years.

This bill would specify that no deduction would be allowed for the same expenses for which the credit was allowed.

This bill would allow the FTB to promulgate rules and regulations to administer and enforce this credit.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following concerns:

The definition of "nonprofit educational assistance organization" (organization) has several grammatical and structural issues that make this bill confusing to read and difficult to administer. For example, it appears that the author intended that:

(a) to qualify as an organization for the purposes of this bill, 90% of its "annual revenue" must be distributed toward educational assistance. However, as written in the bill, the terms "annual revenue" and "qualified contributions" appear to be used interchangeably throughout this definition, even though the terms have different meanings.

(b) at least 90% of an organization's "annual revenue" be distributed toward educational assistance with no more than 10% going for marketing and administrative expenses. However, this bill specifies that no more than 10% of the 90% distribution toward educational assistance be used for marketing and administrative expenses and does not address the remaining percentage.

(c) an organization must demonstrate a pattern of giving priority in awarding scholarships to pupils with the greatest need. As written, this bill would require that *the pupil* to whom the scholarship is awarded, not the organization, must demonstrate this pattern.

(d) at least 65% of the 90% of “annual revenue” required to be distributed toward educational assistance must be used to provide scholarships to qualifying pupils and the remaining 35% or less may be used to provide scholarships to non-qualifying pupils. As written, this bill would require allocation of at least 65% of **all** money received to provide qualifying pupils with scholarships, which appears to conflict with the 90% requirement discussed above.

Additionally, the credit amount is based on qualified contributions made by a taxpayer during a *taxable* year; the organization must meet certain qualifications based on a state *fiscal* year; and scholarships are issued based on a *school* year. All of these types of years begin and end with different dates. It would be helpful if only one type of measurement period or “year,” preferably “taxable year,” was used to reduce potential confusion and administrative complexity.

Definitions are needed for “educational assistance,” “administrative expenses,” “greatest need,” “state’s share,” “total program,” “funded pupil count,” and “private educational supplies and materials.”

In addition to the above concerns with the definition of “nonprofit educational assistance organization,” the last two subparagraphs of this definition are extremely confusing and multiple concepts are addressed. The author may wish to consider revising the language.

Within the definition of “nonprofit educational assistance organization,” several credit requirements are specified. The department does not have the expertise or ability to verify many of these requirements including information pertaining to pupils, pupil funding, transportation funding, attendance, and school district funding. In addition, state law restricts the release of information pertaining to pupil records. School districts do not have a method for tracking individual students. Information is not available to determine if a particular student who receives a scholarship met the state’s compulsory attendance requirement. Further, no requirement is provided for the school, or school district, to provide pupil or funding information to the organization, the taxpayer, or the department. Verification of these credit requirements would be difficult, if not impossible.

This bill contains language that would specifically grant the FTB the authority to prescribe rules or regulations to administer and enforce the provisions of this new credit. However, existing law already provides FTB the authority to prescribe interpretive regulations (Revenue and Taxation Code §19503). Thus, it is unclear if the author intended to provide FTB with a specific legislative delegation of additional regulatory authority to prevent potential misuse of this credit.

LEGISLATIVE HISTORY

AB 1625 (Pescetti, 2001/2002) would create two credits related to education: (1) for contributions to a public school to support its extracurricular activities; and (2) for donations to a nonprofit charitable organization that provides private school scholarships to low-income children. This first year bill died for failing to pass its house of origin by January 31st of the second year of the legislative session.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws do not provide a credit comparable to the credit allowed by this bill. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

If the implementation considerations addressed in this analysis are resolved, the department's costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

Revenue losses from this bill are projected to be in the following orders of magnitude:

Estimated Revenue Impact of SB 1273 As Introduced January 15, 2002 Enactment Assumed After 6/30/02 (In \$Millions)			
Fiscal Years	2002/2003	2003/2004	2004/2005
Revenue Impact (Rounded)	-\$170	-\$185	-\$215

Any possible changes in employment, personal income, or gross state product that might result from this bill are not taken into account.

Revenue Discussion

Revenue losses would be determined by the number of taxpayers making cash contributions and the amount of those contributions made during a taxable year to a qualified nonprofit education assistance organization to support certain students attending public or nonpublic K-12 schools in this state.

This bill would permit taxpayers to reduce their state income tax liabilities significantly. Many taxpayers will redirect cash contributions normally made and claimed as deductions to take advantage of this significant tax credit. Other taxpayers will start making contributions. The assumptions for the revenue estimate in the chart above are based on prior analyses of similar educational assistance tax credit proposals.

According to departmental data, the total number of taxpayers making charitable cash contributions (individuals and businesses) was over 4.3 million for tax year 1998.

It was assumed that the number of taxpayers claiming this credit would be equal to 5% of existing contributors during the first taxable year (gradually growing to 7% in 2004/2005 and years thereafter), and that each contributor would contribute \$1,000 per taxable year on average.

For the deduction-offset calculation, it was assumed that 75% of credit claimants would redirect their normal contributions to receive this enhanced tax benefit.

ARGUMENTS/POLICY CONCERN

This bill does not contain a sunset date. Sunset dates generally are provided to allow periodic review by the Legislature.

This bill would provide a credit for making monetary donations to nonprofit organizations for scholarships to students equal to 70% of the donation. In combination with the federal deduction for a charitable contribution, some taxpayers could receive a credit for 100% or more of the expense. The department has found that credits in an amount equal to or in excess of the incurred costs have the potential to lead to abuse because the taxpayer is not at risk for the activity that generates the credit.

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